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Proposed revision of article 26, Exchange of information, of the United Nations Model Double Taxation Convention between Developed and Developing Countries*

Summary

Recent developments in exchange of information for tax purposes, including the work of the Organization for Economic Cooperation and Development (OECD) and the 2005 revision by OECD of article 26, Exchange of information of the OECD Model Tax Convention on Income and on Capital, suggest (a) an updating by the United Nations Committee of Experts on International Cooperation in Tax Matters of article 26, Exchange of information of the United Nations Model Double Taxation Convention between Developed and Developing Countries and (b) additional work by the Committee of Experts in liaison with OECD, on what constitutes effective exchange of information for the purposes of article 26 of the United Nations Model Income Tax Treaty.

* The present paper, which was prepared by Mr. David Spencer, draws on several of his articles that had appeared in the *Journal of International Taxation*. The views and opinions expressed are those of the author and do not necessarily represent those of the United Nations.

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Introduction

1. Recent developments in international commerce and investment have resulted in the need for increased coordination and cooperation between Governments in international tax matters, including increased exchange of information in tax matters. These recent developments include the accelerating pace of globalization, the progressive liberalization of cross-border trade and investment, the growth in the number and size of multinational enterprises, the increased number and volume of international financial and commercial transactions, the greater complexity of many of those transactions, the explosive growth of electronic commerce and banking, transfer pricing issues, and the increased use by taxpayers of low-tax or no-tax jurisdictions, including the shifting of income by taxpayers to such low-tax or no-tax jurisdictions, and the use of tax-free regimes in offshore and also onshore jurisdictions for capital flight.[1]

2. In view of these developments, Governments have become more concerned about tax evasion in the international context and the resulting loss of government tax revenues. Consequently, Governments have recognized the increased need to cooperate in order to develop (a) consistent methods of allocation of income and expenses between different taxing jurisdictions in order to resolve transfer pricing issues including the possible inconsistent treatment of the same transaction by different jurisdictions and (b) coordinate their efforts to limit tax evasion in the international context.[2]

3. Increased coordination and cooperation between Governments entails, inter alia, increased exchange of information in tax matters. Governments have thus been pressured into broadening the scope of exchange-of-information clauses in international agreements, including efforts to impose greater limitations on bank secrecy and other confidentiality laws in tax matters.[3] Also, Governments have taken other initiatives against bank secrecy and other confidentiality laws in non-tax matters, in cases, for example, of money-laundering, corruption, financing of terrorism and other crimes. For example, recent multifaceted efforts to combat corruption have added to the pressure exerted by the initiatives against bank secrecy. The United Nations Convention against Corruption, adopted by the General Assembly in its resolution 58/4 of 31 October 2003, promotes standard measures and intergovernmental cooperation against corruption. Article 40 thereof presents another line of attack against bank secrecy, providing that "(e)ach State party shall ensure that, in the case of domestic criminal investigations of offences established in accordance with this Convention, there are appropriate mechanisms available within its domestic legal system to overcome obstacles that may arise out of the application of bank secrecy laws".

4. In view of these developments, article 26, Exchange of information, of the United Nations Model Double Taxation Convention between Developed and Developing Countries (hereinafter referred to as United Nations Model Income Tax

[1] See Organization for Economic Cooperation and Development (OECD), *Harmful Tax Competition: An Emerging Global Issue* (1998 OECD report) (Paris, 1998), introduction and chap. 1; and OECD, *Improving Access to Bank Information for Tax Purposes* (2000 OECD report) (Paris, 2000), paras. 10, 11, 36-47 and 62-65.

[2] 1998 OECD report, chap. 3.

[3] See 1998 OECD report, paras. 18, 46, 47, 49, 52-54, 59, 62, 64-67, 73, 75, 76, 94, 95, 113-117, 131, and 133-135; and also 2000 OECD preface, chap. 1 and paras. 48-55.

Treaty)[4] should be reviewed in order to determine whether article 26 (hereinafter referred to as UN Model article 26) should be revised — or, in effect, updated.

5. The Organization for Economic Cooperation and Development (OECD) has stressed the need for increased exchange of information in tax matters, inter alia, in its 1998 and 2000 reports (see note 1). OECD issued in 2002 the Model Agreement on Exchange of Information on Tax Matters (hereinafter referred to as OECD Model TIEA), which was developed by the OECD Global Forum Working Group on Effective Exchange of Information and resulted from the work undertaken by OECD to address harmful tax practices beginning with the 1998 OECD report (see OECD Model TIEA, introduction and paras. 1 and 2). The OECD Model TIEA (introduction, para. 3) confirms that "(t)he 1998 Report identified the lack of *effective* exchange of information as one of the key criteria in determining harmful tax practices" (emphasis added). (It should be noted that the OECD Model TIEA is only an exchange-of-information agreement — it is not a comprehensive model income tax treaty.)

6. OECD has emphasized, through use of the term "effective exchange of information", that exchange of information between Governments should be *effective*.

7. In January 2003, the OECD Committee on Fiscal Affairs (hereinafter referred to as OECD Fiscal Committee) approved a revised article 26, Exchange of information (hereinafter referred to as 2003 OECD article 26) of the OECD Model Tax Convention on Income and on Capital (hereinafter referred to as OECD Model Income Tax Treaty); and in July 2005, the OECD Council approved a further revised article 26, Exchange of Information (hereinafter referred to as 2005 OECD article 26), in a revised OECD Model Income Tax Treaty and also revised the Commentary on OECD article 26.

8. UN Model article 26 is very similar to (but not the same as) 2003 OECD article 26. Therefore, in order to determine whether UN Model article 26 should be updated, it is advisable to review the changes in 2003 OECD article 26 made by the OECD Fiscal Committee in issuing 2005 OECD article 26.

I. Significant issues in exchange of information

9. The following are significant issues with regard of exchange-of-information clauses in tax treaties:

(a) Whether any changes should be made in the exchange-of-information obligations of the transmitting State (the State transmitting the information);

(b) Whether any changes should be made in the purposes for which the receiving State (the State receiving the information) can use the information received from the transmitting State;

(c) Whether a "domestic tax interest requirement" in the transmitting State should limit the obligation of the transmitting State to exchange information, that is to say, whether the transmitting State has the obligation to exchange information

[4] United Nations publication, Sales No. E.01.XVI.2.

requested of it even if the transmitting State does not need such information for its own tax purposes;

(d) Whether the obligation to exchange information should "override" bank secrecy and other confidentiality laws in the transmitting State;

(e) Whether a dual criminality (or double incrimination) requirement in the transmitting State should limit the obligation of the transmitting State to exchange information, that is to say, whether, if the transmitting State has a dual criminality requirement, the transmitting State will provide information to the receiving State only if the alleged violation would constitute a crime under the laws of both the transmitting State and the receiving State;

(f) What information the transmitting State should normally receive from domestic sources in order that the transmitting State may be able to *effectively* exchange information with the receiving State;

(g) What practical steps the transmitting State and the receiving State should take in order to facilitate and improve *effective* exchange of information.

Any changes in UN Model article 26 will require corresponding changes in the Commentary thereon.

II. Changes in the obligations of the transmitting State to exchange information

10. A significant issue is the scope of the taxes to be covered by the exchange-of-information clause. UN Model article 26 (1) limits the exchange of information to such "information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention, insofar as the taxation thereunder is not contrary to the Convention". Article 2 (1) of the United Nations Model Income Tax Treaty states that "(T)his Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities irrespective of the manner in which they are levied".

11. However, both 2003 OECD article 26 and 2005 OECD article 26 are broader and cover "information as is necessary for carrying out the provisions of this Convention or of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention"; that is to say, exchange of information under both 2003 OECD article 26 and 2005 OECD article 26 can also apply to taxes other than those covered by the OECD Model Income Tax Treaty. (OECD announced in its 1998 report (para. 117) its intention to amend article 26 (1) "so as to extend its scope to taxes not otherwise covered by the Convention". This change was made in OECD article 26 in 2002.) Therefore, 2003 OECD article 26 and 2005 OECD article 26 provide a broader coverage than UN Model article 26. It is suggested that, in this regard, UN Model article 26 be modified to reflect the provisions of 2003 OECD article 26 and 2005 OECD article 26.

12. Also, UN Model article 26 (1) states, in relevant part: "The exchange of information is not restricted by article 1." However, 2003 OECD article 26 and 2005

OECD article 26 are broader and state: "The exchange of information is not restricted by Articles 1 and 2." It is suggested that the relevant language in UN Model article 26 be modified to read as follows: "The exchange of information is not restricted by Articles 1 and 2."

13. Therefore, it is suggested that the relevant wording in UN Model article 26 be as follows:

> ... concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

14. UN Model article 26 (1) covers two separate issues: (a) the obligations of the transmitting State to exchange information and (b) the obligations of the receiving State with regard to information received by the receiving State from the transmitting State. 2003 OECD article 26 also treated these two separate issues within article 26 (1). 2005 OECD article 26 modified that and treats separately each of these two issues, in two separate paragraphs: article 26 (1) (obligations of the transmitting State to exchange information) and article 26 (2) (obligations of the receiving State with regard to information received from the transmitting State).

15. As these are two separate issues, it is suggested that UN Model article 26 be modified so that they can be covered in two separate paragraphs, with issue (a) to be covered in a revised article 26 (1) (obligations of the transmitting State to exchange information, and issue (b) to be covered in a new article 26 (2) (obligations of the receiving State with regard to information received from the transmitting State). Consequently, the present UN Model article 26 (2) would be renumbered as article 26 (3). This is basically a matter of style, but it is important that UN Model article 26 be as well written and as logically organized as possible, in order to facilitate compliance.

16. In accordance with the comments in paragraphs 10-13 above, the reference in the fourth sentence of UN Model article 26 (1) (which is being changed to article 26 (2)) to "the taxes which are the subject of the Convention" would be changed to "the taxes referred to in paragraph 1".

17. Further, the OECD Fiscal Committee made the following additional changes in 2003 OECD article 26 (1), when it issued 2005 OECD article 26 (and it is suggested that those changes be made in UN Model article 26 (1)):

(a) The word "necessary" in 2003 OECD article 26 (1) was deleted and replaced by the words "foreseeably relevant". The OECD Commentary (para. 5) on this change indicates that "(T)he standard of 'foreseeable relevance' is intended to provide for exchange of information in tax matters to the widest possible extent and, at the same time, to clarify that Contracting States are not at liberty to engage in 'fishing expeditions' or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer". (The phrase "foreseeably relevant" also appears in article 1 of the OECD Model TIEA and in article 4 (1) of the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters; see also Commentary, paras. 3-4, of the OECD Model TIEA.) It is suggested that the same change be made in UN Model article 26;

(b) In 2005 OECD article 26, the words "to the administration or enforcement" were added in paragraph 1 thereof, before the words "of the domestic laws". It is suggested that the same change be made in UN Model article 26 in paragraph (1) thereof in order to expand the coverage of that article. Such words also appear in article 1 of the OECD Model TIEA.

18. However, the Commentary on 2005 OECD article 26 (para. 4.1) states:

> 4.1. Many of the changes that were then made to the Article (26) were not intended to alter its substance, but instead were made to remove doubts as to its proper interpretation. For instance, the change from "necessary" to "foreseeably relevant" and the insertion of the words "to the administration or enforcement" in (Article 26) paragraph 1 were made to achieve consistency with the Model Agreement on Exchange of Information on Tax Matters (OECD Model TIEA) and were not intended to alter the effect of the provision

19. UN Model article 26 (1) includes the following words: "in particular for the prevention of fraud or evasion of such taxes". These words appear in neither 2003 OECD Model article 26 nor 2005 OECD Model article 26. The Commentary on these words (A. General considerations, para. 2) states:

> 2. The words "in particular for the prevention of fraud or evasion of such taxes" were inserted at the request of members of the Group, mainly from developing countries, who wanted to emphasize that the exchange of information under article 26 covers the purpose of preventing fraud or evasion. The exchange of information for the prevention of fraud or evasion is subject to the general condition embodied in the first sentence of paragraph 1, that the taxation involved is not contrary to the Convention.

It is suggested that, as such words were intentionally included in UN Model article 26, they remain in article 26 (1).

III. Changes in the purposes for which the receiving State can use the information received from the transmitting State

20. 2005 OECD article 26 added the words "or the oversight of the above" in article 26 (1), in order to expand the possible use of exchanged information. These words indicated that information exchanged under article 26 could be made available to oversight bodies that supervised tax administration and enforcement authorities, such as legislature (see para. 12.1 of the Commentary on 2005 OECD article 26). It is suggested that a similar addition be made in UN Model article 26, as this would expand the scope of the article.

21. Therefore, in view of the comments contained in paragraphs 10-20, above, it is suggested that UN Model article 26 (1) and (2) read as follows:

> 1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities,

insofar as the taxation thereunder is not contrary to the Convention, in particular for the prevention of fraud or evasion of such taxes. The exchange of information is not restricted by articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State. However, if the information is originally regarded as secret in the transmitting State, it shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes but may disclose the information in public court proceedings or in judicial decisions. The competent authorities shall, through consultation, develop appropriate conditions, methods and techniques concerning the matters in respect of which such exchanges of information shall be made, including, where appropriate, exchange of information regarding tax avoidance.

22. 2003 OECD article 26 (2) was not changed in 2005 OECD article 26, except that in 2005 OECD article 26 (a) it was renumbered as article 26 (3) because 2003 OECD article 26 (1) was divided into article 26 (1) and 26 (2), and (b) it refers to paragraphs 1 and 2 and not only to paragraph 1. Therefore, in view of UN Model article 26 (1) being "divided" into UN Model article 26 (1) and (2) (as 2005 OECD article 26 was divided), it is suggested that UN Model article 26 (2) be renumbered as article 26 (3), and that such article 26 (3) refer to paragraphs 1 and 2. See paragraphs 56 and 57 below for additional comments about revised UN Model article 26 (3).

IV. No domestic tax interest requirement in the transmitting State

23. In order that the obligation to exchange information may be broad, a domestic tax interest requirement should not limit the obligation to exchange information. Provided that the information requested is for a purpose specified in article 26, paragraph 1, the fact that the transmitting State does not need such information for its own tax purposes does not seem relevant to whether the transmitting State should provide to the receiving State the requested information (see also the 2000 OECD report, para. 21 (b)).

24. 2005 OECD article 26 added a new article 26 (4) stating that, notwithstanding the exceptions in 2005 OECD article 26 (3), a domestic tax interest requirement does not limit the obligation to exchange information. Article 26 (4) reads:

If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of (article 26 (3)) but in no case shall such limitations be construed to permit a Contracting State to

decline to supply information solely because it has no domestic interest in such information.

25. The OECD Model TIEA (article 5 (2) and para. 43 of the Commentary thereon) also provides that a domestic tax interest requirement does not limit the obligation to exchange information.

26. The OECD Commentary on 2005 OECD article 26 (4) (para. 19.7) clarifies that the term "information gathering measures" means "laws and administrative or judicial procedures that enable a Contracting State to obtain and provide the requested information". The same definition appears in article 4 (1) (l) of the OECD Model TIEA.

27. Therefore, it is recommended that a clause similar to 2005 OECD article 26 (4) be added to UN Model article 26, as follows:

> 4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitation of paragraph 3 but in no case shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

V. Override of bank secrecy and other confidentiality laws in the transmitting State

28. The most significant recent development is that exchange-of-information provisions in tax treaties should "override" bank secrecy and other confidentiality laws in the transmitting State.

29. The 1998 OECD report (paras. 18, 46, 47, 49, 52-54, 59, 62, 64-67, 73, 75, 95 and 113-117) stressed the need for effective exchange of information and emphasized that bank secrecy and other confidentiality laws were an obstacle to the effective exchange of information. The 2000 OECD report (preface and chaps. 1, 2 and 3) also stressed the importance of ensuring that exchange-of-information provisions in tax matters would override bank secrecy and other confidentiality laws. The November 2000 OECD Framework for a Collective Memorandum of Understanding on Eliminating Harmful Tax Practices (hereinafter referred to as November 2000 OECD Framework) required that jurisdictions classified by OECD as cooperative tax haven jurisdictions have access to bank information and information about beneficial ownership of local entities that might be relevant for civil and criminal cases. The OECD Model TIEA (article 5 (4)) provides in effect for an override in certain instances of bank secrecy and other confidentiality rules (see the Commentary on the OECD Model TIEA, paras. 46-56).

30. The most significant change in 2005 OECD article 26 is the addition of article 26 (5), which provides generally for an override of bank secrecy laws as follows:

> In no case shall the provisions of (article 26 (3)) be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person

> acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

31. The Commentary (para. 19.10) on 2005 OECD article 26 (5) confirms, in relevant part, that "(t)he vast majority of OECD member countries" override bank secrecy laws:

> While (article 26 (5)), which was added in 2005, represents a change in the structure of article 26 it should not be interpreted as suggesting that the previous version of article 26 did not authorise the exchange of such information. The vast majority of OECD member countries already exchanged such information under the previous version of article 26 and the addition of paragraph 5 merely reflects current practice.

32. Moreover, the Commentary (para. 19.11) on 2005 OECD article 26 (5), in relevant part, states:

> The addition of this paragraph (5) to article 26 reflects the international trend in this area as reflected in the Model Agreement on Exchange of Information on Tax Matters (OECD Model TIEA) and as described in the report, *Improving Access to Bank Information for Tax Purposes* (OECD, 2000). In accordance with that report, access to information held by banks or other financial institutions may be by direct means or indirectly through a judicial or administrative process. The procedure for indirect access should not be so burdensome and time-consuming as to act as an impediment to access to bank information.

33. Further, the Commentary (para. 19.12) on 2005 OECD article 26 (5) defines "fiduciary" and "agency" broadly:

> Paragraph 5 also provides that a Contracting State shall not decline to supply information solely because the information is held by persons acting in an agency or fiduciary capacity ... A person is generally said to act in a "fiduciary capacity" when the business that the person transacts, or the money or property that the person handles, is not its own or for its own benefit, but for the benefit of another person as to whom the fiduciary stands in a relation implying and necessitating confidence and trust on the one part and good faith on the other part, such as a trustee. The term "agency" is very broad and includes all forms of corporate service providers (for example, company formation agents, trust companies, registered agents, lawyers).

34. Therefore, it is recommended that a clause similar to article 26 (5) of 2005 OECD article 26 be added to UN Model Income article 26, as follows:

> 5. In no case shall the provision of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

35. The Commentary (para. 19.14) on 2005 OECD article 26 (5) refers, in relevant part, to information protected legally by confidential relationship:

> ... a legal representative acting for a client may be acting in an agency capacity but for any information protected as a confidential communication

between attorneys, solicitors or other admitted legal representatives and their clients, article 26, paragraph 3, continues to provide a possible basis for declining to supply the information.

VI. No dual criminality requirement

36. If the transmitting State has a dual criminality requirement (sometimes referred to as "double incrimination"), the transmitting State will provide information to the receiving State only if the alleged violation would constitute a crime under the laws of both the transmitting State and the receiving State (see the 2000 OECD report, para. 21 (c) and note 7).

37. 2005 OECD article 26 does not have a provision overriding any such dual criminality requirement in the transmitting State; and the Commentary thereon does not refer to this issue.

38. However, the OECD Model TIEA provides for an override of any dual criminality requirement. article 5 (1) of the OECD Model TIEA (see para. 40 of the Commentary thereon) requires the transmitting State to provide, on request, information for the purposes (for both civil and criminal tax matters) referred to in article 1 of the OECD Model TIEA, without regard to whether the conduct being investigated would constitute a crime under the laws of the transmitting State if the conduct occurred in the transmitting State. article 5 (1) of the OECD Model TIEA states:

> 1. The competent authority of the requested Party shall provide upon request information for the purposes referred to in article 1. Such information shall be exchanged without regard to whether the conduct being investigated would constitute a crime under the laws of the requested Party if such conduct occurred in the requested Party.

39. In view of this, it is suggested that the following clause similar to article 5 (1) of the OECD Model TIEA be added to the United Nations Model Income Tax Treaty, as paragraph 26 (6):

> 6. A Contracting State shall exchange information with the other Contracting State pursuant to this article 26 without regard to whether the conduct being investigated would constitute a crime under the laws of that Contracting State if such conduct occurred in that Contracting State.

VII. What information should the transmitting State normally receive from domestic sources in order that the transmitting State may be able to effectively exchange information with the receiving State?

40. What information should a Government obtain automatically from banks, other financial institutions and other payors of income in that country to overcome de facto bank secrecy and to facilitate effective exchange of information by that Government with other Governments pursuant to exchange-of-information clauses in income tax treaties or exchange-of-information agreements?

41. The Commentary (paras. A.6-A.18) on UN Model article 26 and the Commentary (para. 9 and 9.1) on 2005 OECD article 26 confirm that article 26 (1) of the United Nations Model Income Tax Treaty and article 26 (1) of the OECD Model Income Tax Treaty, respectively, provide for information to be exchanged by three different methods: (a) on request, (b) automatically (routinely) and (c) spontaneously (see also the Joint Council of Europe/OECD Convention on Mutual Administrative Assistance in Tax Matters, articles 4-7).

42. However, exchange of information on request is the only method required by (a) UN Model article 26, (b) 2003 OECD article 26, (c) 2005 OECD article 26 and (d) the OECD Model TIEA. UN Model article 26 and 2005 OECD article 26 do not refer specifically to automatic exchange of information, but the Commentary on each of those two articles provides for discretionary rather than mandatory automatic exchange of information, that is to say, the two Contracting States would have to agree specifically to exchange information automatically. UN Model article 26 and the 2005 OECD article 26 also do not require spontaneous exchange of information but the Commentary on each of those two articles provides for spontaneous exchange of information. The OECD Model TIEA envisions exchange of information only on request: the OECD Model TIEA and the Commentary thereunder do not provide for automatic exchange of information nor spontaneous exchange of information (but para. 39 of the Commentary thereon does refer to automatic and spontaneous exchange of information). (The European Union Directive on the Taxation of Savings Income provides for mandatory automatic exchange of information on certain cross-border interest payments to individuals, except for three EU countries (Austria, Belgium and Luxembourg) and Switzerland, which have agreed for the interim period to adhere to the alternative method of a withholding tax, subject to the provisions of the Directive and the EU-Switzerland agreement).

Automatic exchange of information

43. If the transmitting State is to exchange information automatically with the receiving State, payors of income in the transmitting State must report automatically the relevant information to the transmitting State. If the transmitting State does not generally receive that information from payors of income by a method of automatic reporting, the transmitting State generally cannot exchange information automatically with tax treaty partners. With regard to the work of OECD on automatic exchange of information, see the discussion in paragraph 59 below.

VIII. Position of the Organization for Economic Cooperation and Development on automatic reporting

44. When a Government wants information for domestic compliance and tax administration purposes, it can require local payors of income to report such income automatically through the use of taxpayer identification numbers (TIN) and the tax authorities can match such automatically reported income by computer with the information on the taxpayer's tax return filed with that same TIN. Such automatic reporting by payors of income could be considered the most effective procedure for enabling a Government to acquire relevant tax information.

45. OECD has emphasized the benefits to tax administrations of the automatic reporting of information by financial institutions for both (a) domestic tax compliance and tax administration and (b) the automatic exchange of information with tax treaty partners:

> Many tax administrations also receive certain types of information from banks (e.g., amount of interest payments) on an automatic basis, which greatly facilitates domestic tax administration and potentially expands the types of information that may be exchanged with treaty partners on an automatic basis ... Tax administrations and taxpayers can benefit from automatic reporting of information by financial institutions. Automatic reporting of information by financial institutions can be very useful to tax administrations for the verification of information reported by taxpayers. Automatic reporting also can serve to increase voluntary compliance. If taxpayers know that their banks are required to report income information to the tax authorities, taxpayers will be more likely to file accurate returns regarding this income. In addition, automatic reporting enables tax administrations to implement programmes that may benefit taxpayers by reducing their compliance burden. Without access to bank information, none of these benefits can be achieved. Improvements in automatic reporting and exchange of information are being examined in the context of the (Fiscal) Committee's study of the use of withholding taxes and/or exchange of information to enhance the taxation of cross-border interest flows (2000 OECD report, preface and paras. 5, 58, 59 and 78) ... The Committee will continue to work on improvements in automatic reporting and automatic exchange of information in connection with the study of the use of withholding taxes and/or exchange of information to enhance the taxation of cross-border interest flows (ibid., para. 109 and preface).

IX. Problems with exchange of information on request: de facto bank secrecy

46. With regard to exchange of information on request, there are at least two possible situations in which the receiving State may want information about one of its residents, citizens or other taxpayers from the transmitting State.

47. In the first, the receiving State knows that one its residents, citizens or other taxpayers has a bank account or other interest-bearing investment in the transmitting State, but the receiving State does not know the details of the account (name of the account, financial institution where the interest-bearing account is located, identity of the payor of the interest income). In this situation, if the transmitting State does not have an automatic reporting system with regard to interest income earned by non-resident aliens and foreign corporations ("foreign persons"), the transmitting State does not normally have sufficient details to obtain from respective payors of income within that transmitting State ("payors of income") the relevant information about the foreign persons receiving such income. Even though the income tax treaty between the transmitting State and the receiving State may have an exchange-of-information clause similar to 2005 OECD article 26 overriding bank secrecy and other confidentiality laws in the transmitting State, in this situation the transmitting State cannot comply with the request of the receiving State. A clause similar to 2005

OECD article 26 (5) and the suggested revised UN Model article 26 (5) would have no effective impact in this fact situation and therefore the result would be de facto bank secrecy.

48. In the second situation, the receiving State knows that its resident or citizen or other taxpayer has an interest-bearing investment in the transmitting State and sufficient details of that investment (name of account and financial institution where the account is located). Whether or nor the transmitting State has an automatic reporting system with regard to interest earned by foreign persons, the receiving State can provide to the transmitting State enough details for the transmitting State to obtain the relevant information from the payors of income. Therefore, in this fact situation, the transmitting State can comply with the exchange-of-information request of the transmitting State. A clause similar to 2005 OECD article 26 (5) and the suggested revised UN Model article 26 (5) in the income tax treaty between the transmitting State and the receiving State would override any bank secrecy laws in the transmitting State.

49. In summary, exchange of information on request can constitute effective exchange of information if (a) the transmitting State has the relevant information from pavors of income as a result of an automatic reporting system or (b) the receiving State has enough relevant details and gives those details to the transmitting State in order for (i) the transmitting State to obtain the requested information, even if the transmitting State does not have an automatic reporting system and (ii) the transmitting State to exchange the information with the receiving State. Otherwise, de facto bank secrecy in the transmitting State can result.

X. Further obstacles to effective exchange of information

50. The transmitting State can place obstacles in the way of achieving an effective exchange of information with a tax treaty partner in spite of an exchange-of-information clause similar to 2005 OECD article 26.

51. First, the transmitting State may require all banks, other financial institutions and other payors of income located within that transmitting State to report automatically (through a system of computerized taxpayer identification numbers) to its tax authorities all payments of income to residents of that State. As indicated above, OECD has in effect indicated that such automatic reporting is the most effective method of enabling a Government to obtain the relevant tax-related information. However, the transmitting State may exempt from taxation in the transmitting State certain payments by payors of income located in that transmitting State to non-residents and foreign companies not doing business in the transmitting State. If the transmitting State does not impose any tax on such income, it may exempt from the automatic reporting requirement those payments from payors of income in the transmitting State to foreign persons. The transmitting State may not require those foreign persons to obtain a TIN or provide a TIN to such payors of income in the transmitting State. Those payors of income may have to comply with all applicable know-your-customer (the respective payee) requirements in the transmitting State and also obtain evidence from each payee of income that he/she/it is a foreign person. However, such payors of income would not be required to provide such information automatically to the tax authorities of the transmitting

State. Consequently, the transmitting State may have no relevant information about the identity of those foreign persons or about the income paid by payors of income to such foreign persons. In this way, the transmitting State attracts investments from foreign persons who know that, in the general case, the transmitting State will not have the relevant information to exchange with the receiving State. The result is de facto bank secrecy in the transmitting State; and because of such de facto bank secrecy in the transmitting State, the foreign person may attempt to evade any applicable tax in his/her/its country of residence, the receiving State, which does not receive the relevant information.

52. The 1998 OECD report (recommendations 4, 7 and 8 (chap. 3, sects. II and III) and paras. 62, 64-67, 75, 94, 95 106, 107 and 112-116) would in effect categorize this as a harmful preferential tax regime/harmful tax practice because the transmitting State (the country of the source of the income) exempts such income from tax and facilitates tax evasion by the foreign person in his/her/its country of residence. *Recommendation 4 concerning foreign information reporting rules* proposes that countries that do not have rules concerning reporting of international transactions and foreign operations of resident taxpayers consider adopting such rules and that countries exchange information obtained under these rules. *Recommendation 7 concerning access to banking information for tax purposes* proposes that, in the context of counteracting harmful tax competition, countries should review their laws, regulations and practices that govern access to banking information by tax authorities with a view to removing impediments to the access to such information by tax authorities. *Recommendation 8 concerning greater and more efficient use of exchanges of information* proposes that countries should undertake programmes to intensify exchange of relevant information concerning transactions in tax havens and preferential tax regimes constituting harmful tax competition.

53. Second, the transmitting State may take even more extreme measures. For example, the transmitting State may provide that foreign persons investing in the transmitting State can channel those investments through a "foreign intermediary" (a foreign financial institution) that agrees to comply with applicable know-your-customer requirements similar to those in the transmitting State. The investments in the transmitting State by the foreign persons could be made in the name of the foreign intermediary, which confirms to the payors of income in the transmitting State that the beneficial owner is a foreign person and that all applicable know-your-customer requirements are complied with. By using this foreign intermediary method, the payors of income in the transmitting State do not have any relevant details about the foreign persons investing in the transmitting State. Those relevant details are held by a financial institution in a foreign country, frequently offshore. The result: de facto bank secrecy in the transmitting State which is not overridden by 2005 OECD article 26 in spite of the override in article 26 (5) and in the suggested revised UN Model article 26 (5) of bank secrecy and other confidentiality laws in the transmitting State. The 1998 OECD report in effect categorizes such treatment as a harmful preferential tax regime/harmful tax practice (see para. 52 above).

54. However, neither 2005 OECD article 26 nor the Commentary thereon actually requires the transmitting State to obtain information, and to have information available to it, in order for that transmitting State to be able to exchange information with the receiving State. 2005 OECD article 26 and the suggested changes to UN

Model article 26 will facilitate effective exchange of information by overriding bank secrecy and other confidentiality laws in the transmitting State (de jure bank secrecy); but those articles do not require the transmitting State to obtain sufficient information to overcome the de facto bank secrecy in the transmitting State in the fact situations described in paragraphs 47 and 48, and 51 and 53 above.

55. The 1998 OECD report (paras. 12, 52-54, 59, 62, 64, 66, 67, 75, 76, 106-107, and 112-117) and the 2000 OECD report (preface and chaps. 1-3) have focused attention on the need for *effective* exchange of information, and the need for the transmitting State to have, according to domestic law and practice, access to the relevant information in order to make the exchange of information *effective*.

56. However, UN Model article 26 (2) states that:

> In no case shall the provision of paragraph 1 be construed so as to impose on a Contracting State the obligation:
>
> (a) To carry out administrative measures at variance with the laws and administrative practices of that or the other Contracting State;
>
> (b) To supply information that is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
>
> (c) To supply information that would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (*ordre public*).

2005 OECD article 26 (3) and the suggested revised UN Model article 26 (3) have similar language. However, 2005 OECD article 26 and the suggested revised UN article 26 provide that such language is subject to article 26 (4) (no domestic tax interest requirement) and article 26 (5) (the override of bank secrecy and confidentiality laws).

57. In effect, subject to article 26 (4) and 26 (5), such language in article 26 (3) enables the transmitting State to permit de facto bank secrecy in the situations described in paragraphs 47 and 48, and 51 and 53 above. This de facto bank secrecy permitted by 2005 OECD article 26 (3) and the suggested revised UN Model article 26 (3) seems contrary to the concept of *effective* exchange of information emphasized in the aforementioned provisions of the 1998 and 2000 OECD reports. Can the transmitting State validly claim that it engages in *effective* exchange of information if it permits such de facto bank secrecy?

XI. What practical steps should Governments take in order to facilitate effective exchange of information?

58. Automatic exchange of information would normally result in voluminous amounts of information, about residents, citizens or other taxpayers of the receiving State deriving income from sources in the transmitting State, being transmitted by the transmitting State to the receiving State ("transmitted information"). In order that the receiving State adequately process such Transmitted Information, the information would have to be codified by a TIN or another identification number adequate for processing by the receiving State. One problem is that the receiving

State can normally process such transmitted information only through a TIN used in the receiving State (rather than a TIN used in the transmitting State). Therefore, the transmitting State would have to transmit to the receiving State the relevant information codified by the TIN used in the receiving State. This would require the transmitting State to compile the relevant information based on the TIN used in the receiving State. If the transmitting State were to compile the relevant information based on a TIN issued by the transmitting State, there would have to be a procedure by which such information was "converted" to information based on a TIN issued by the receiving State, in order for the receiving State to be able to process such information by computer.

59. OECD has worked on this issue. See (a) OECD Council Recommendation on the Use of Tax Identification Numbers in an International Context (C(97)29 (FINAL)) dated 13 March 1997; (b) OECD Council Recommendation on the Use of the Revised OECD Standard Magnetic Format for Automatic Exchange of Information (C(97)30 (FINAL)) dated 13 March 1997; and (c) OECD Council Recommendation on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes (C(2001)28 (FINAL)) dated 22 March 2001, references to all of which were added to paragraph 9 (b) of the Commentary on 2005 OECD article 26. It is suggested that the Committee of Experts on International Cooperation in Tax Matters liaise with OECD on these issues.

XII. Suggestions for additional work to be undertaken by the Committee of Experts on International Cooperation in Tax Matters

60. Therefore, it is suggested that:

(a) The Committee of Experts on International Cooperation in Tax Matters designate a subcommittee to prepare during 2006 a draft revision of the Commentary on article 26, Exchange of information, of the United Nations Model Double Taxation Convention between Developed and Developing Countries, to reflect the changes made to such article 26 at the first meeting of the Committee and that such subcommittee present to all of the members of the Committee by 1 September 2006 the draft of such revised Commentary for consideration by the Committee at its second meeting to be held in Geneva in December 2006;

(b) The Committee of Experts on International Cooperation in Tax Matters designate a subcommittee to liaise during 2006 with the OECD Fiscal Committee on (i) the issue of automatic reporting of income within the transmitting State (discussed in paras. 46-57 above) and (ii) the issue of automatic exchange of information to be conducted by the transmitting State with the receiving State (discussed in paras. 58 and 59 above) and that, in particular:

a. As regards automatic reporting of income, such subcommittee determine what further work, if any, the OECD Fiscal Committee has done and will be doing during 2006 on the automatic reporting of income within the transmitting State, in order to facilitate the effective exchange of information to be conducted by the transmitting State with the receiving State;

b. As regards automatic exchange of information, such subcommittee determine what further work, if any, OECD has done and will be doing during 2006 on the automatic exchange of information between the transmitting State and the receiving State, in order to facilitate the effective exchange of information to be conducted by the transmitting State with the receiving State, including but not limited to any follow-up work by OECD with regard to (i) OECD Council Recommendation on the Use of Tax Identification Numbers in an International Context; (ii) OECD Council Recommendation on the Use of the Revised OECD Standard Magnetic Format for Automatic Exchange of Information; and (iii) OECD Council Recommendation on the Use of the OECD Model Memorandum of Understanding on Automatic Exchange of Information for Tax Purposes including but not limited to the work of the Fiscal Committee on improvements in automatic reporting and automatic exchange of information in connection with the study of the use of withholding taxes and/or exchange of information to enhance the taxation of cross-border interest flows, as referred to in paragraphs 5, 58 and 109 and the preface of the 2000 OECD report;

c. As regards informing the Committee of Experts on International Cooperation in Tax Matters, such subcommittee report on the progress of its work periodically during 2006 to all members of the Committee of Experts and make suggestions thereto on the inclusion of a follow-up item on this issue in the agenda for the 2006 meeting of the Committee of Experts.